



2019 Review of the Australian Domestic Gas Security Mechanism

Submission — Department of Industry, Innovation and Science

Summary

- Affordability and reliability must be at the heart of government energy policy.
- The ADGSM represents a significant intervention to an already highly regulated gas market. Policy uncertainty and regulation had been key factors contributing to the gas supply constraints and very high gas prices.
- Given our general support for market-based solutions, the highly regulatory approach of the ADGSM is only supported as a temporary measure to provide immediate relief to domestic gas customers while the market adjusts to be more competitive, efficient and effective.
- The aim of the ADGSM was to ensure sufficient supply of natural gas to meet the forecast needs of Australian gas consumers. Yet, two years after the introduction of the ADGSM, gas supply in the east coast market remains extremely tight; C&I gas users are finding it very difficult to secure contracts for gas supply; gas prices remain very high and are becoming increasingly unaffordable for many C&I customers.
- The high prices and limited supply have led to a number of closures of several C&I gas users, and the operations of many others are unsustainable over the long-term at current gas prices.
- The introduction of the ADGSM has had no discernible impact on the domestic gas market from the perspective of C&I users.
- There is no indication that the ADGSM is having a negative impact on Australia's international competitiveness, investment reputation or international reputation for quality and reliability.
- There are other regulatory barriers, particularly bans on gas exploration, representing a greater risk to investment in gas field developments.
- There are other market factors, including excess LNG export capacity on the east coast, having a greater impact on investment decisions on new LNG export facilities.
- Federal and State Governments must focus their attention on lifting restrictions on gas exploration and extraction to increase gas supply now. If Governments were to explore the option of a national gas reservation scheme in the future, it should be limited to new projects only.

- The scope of the ADGSM could be broadened to consider both price and sufficiency of supply at the state and regional level and the contingent risks. It should ensure C&I users have access to short- and long-term supply contracts, on reasonable terms and at affordable prices.
- To improve transparency and help the market operate more efficiently, consideration could be given to require gas producers and LNG exporters to publish real time information on the volume of available gas supply, production and delivery costs.

National Gas Strategy

- We recommend that a comprehensive long-term national gas strategy be developed, which aims to ensure domestic gas consumers have access to a functioning gas market.
 - Short-term policy priorities should aim to increase competition, create a more interconnected network and improve the efficiency and effectiveness of the gas market.
 - Long-term policy priorities should aim to remove constraints on exploration and gas-field development to increase domestic supply and drive down prices.
- The strategy needs to support the LNG export sector, which is a major contributor to Australia's trade balance and our GDP. LNG is Queensland's second largest merchandise export. The strategy should also factor in the importance of this trade.
- Effort should be directed at freeing-up the market to competition, rather than the addition of further regulation on what is an already heavily regulated and highly distorted market.
- To ensure consistency of policy and regulation, we recommend the Government work with its State and Territory counterparts through COAG in developing the national gas strategy.

Introduction

The Australian Chamber of Commerce and Industry welcomes the opportunity to comment on the implementation of the Australian Domestic Gas Market Security Mechanism (ADGSM).

Affordability and reliability of energy needs to be at the heart of government energy policy. Supply constraints have driven the average price of gas in the east coast market (NSW, Victoria, Queensland, South Australia and Tasmania) to unprecedented highs over the past five years. Even if they can afford to pay the elevated prices, some commercial and industrial (C&I) gas users have indicated that they are finding it very difficult to contract gas supply. Where gas can be secured, contracts are only short term (12 months). Businesses relying directly or indirectly on gas as feedstock for processing or power generation, face closure or relocation overseas if they cannot continue to operate at current gas prices.

We would like to see increased competition to put downward pressure on the price of gas in the east coast market, while ensuring sufficient and reliable supply to commercial and industrial gas users, as well as residential customers.

The Australian Chamber considers there is an immediate need for action to increase supply to meet the demand of domestic gas customers, particularly C&I gas users, as well as improving access to short- and long-term supply contracts and bring down prices.

The Australian Chamber regards the ADGSM as a temporary, stop-gap measure ahead of broader reforms. These broader reforms are still required.

We recommend the development of a comprehensive national gas strategy. The strategy would aim to achieve a functioning gas market, by removing supply constraints, freeing-up the market to competition and bringing down domestic gas prices, rather adding further regulation.

The following responds to the specific terms of reference of the Review.

The effectiveness and efficiency of the ADGSM in ensuring a sufficient supply of natural gas for Australian consumers with minimum disruption to Australia's liquefied natural gas export industry

Two years after the introduction of the ADGSM, gas supply in the east coast market remains extremely tight. Some C&I gas users are finding it very difficult to secure contracts for gas supply. Gas prices remain very high and are becoming increasingly unaffordable for many C&I customers. A number of gas-reliant businesses have been forced to close their doors.

The aim of the ADGSM was to ensure that there is sufficient supply of natural gas to meet the forecast needs of Australian gas consumers. If a shortfall in the supply of natural gas is forecast, the ADGSM gives the Minister, at his discretion, the power to direct LNG projects that are drawing gas from the domestic market to either limit exports or find offsetting sources of new gas, to make up any domestic shortfall. The ADGSM took effect from 1 July 2017, but the Minister is yet to make a determination that there is insufficient supply to meet domestic demand.

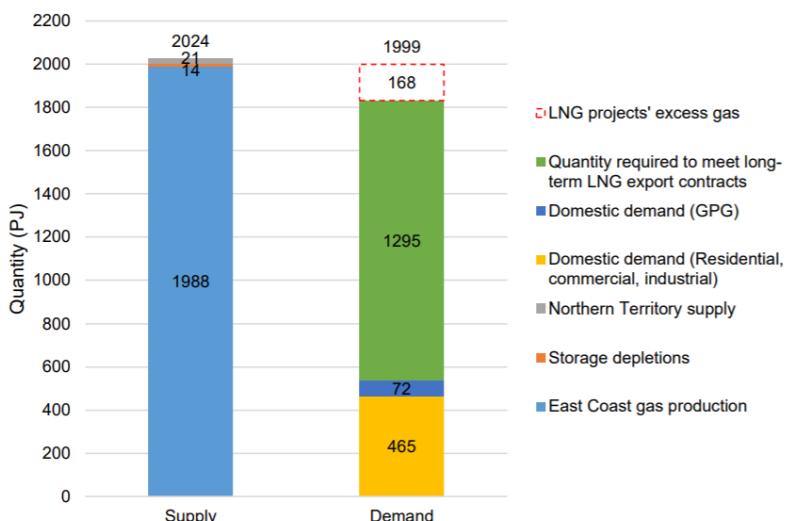
Technically, the east coast market, when viewed as a whole, can be shown to be in balance. Gas supply is marginally higher than demand from domestic customers and LNG exporters. However, when viewed at a more granular level, supply shortfalls can be observed in some regions.

The Australian Energy Market Operator (AEMO) Gas Statement of Opportunities (GSOO) report shows domestic supply increasing slightly in 2018 and 2019.¹ Similarly, the Australian Competition and Consumer Commissions (ACCC) Gas Inquiry report forecasts of the supply-demand balance in the east coast market indicates there is unlikely to be a gas supply shortfall in 2020.² It shows the market to be extremely tight, with supply forecast to be 2,024 PJ and demand at 1,999 PJ, a difference of only 25 PJ or 1.2% (Chart 1).

¹ AEMO Gas Statement of Opportunities

² ACCC Gas Inquiry Report 2017-2020 Interim Report July 2019. p.19

Chart 1: Forecast supply-demand balance in the East Coast Gas Market for 2020



Source: ACCC Gas Inquiry Report 2017-2020 Interim Report July 2019

Despite the AEMO data and ACCC forecasts showing supply and demand in balance, the experience of gas customers, particularly C&I gas users has been different. C&I gas users needing to renew gas supply contracts since 2016, have not been able to secure long-term supply. While some larger C&I users, mainly the larger industrial users, have been able to gain short-term supply contracts, most have been left to rely on the spot market. This is particularly so for smaller C&I gas users reliant on retail gas suppliers, as retailers appear to be favouring residential demand over the needs of their C&I customers. These smaller commercial gas users have little negotiating power, and where they are able to access gas supply contracts they are offered on a ‘take it or leave it’ basis.

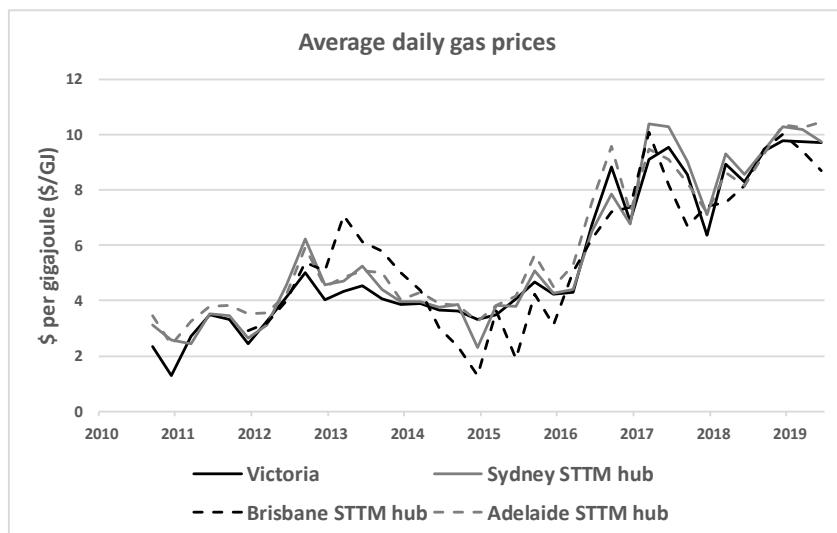
Based on the forecast for gas supply in 2020 from the ACCC Gas Inquiry Report, it is expected the Minister will determine there is sufficient supply to meet demand and will not limit LNG exports under the provisions of the ADGSM in 2020. However, the ACCC analysis also indicates the distribution of this gas is likely to be uneven, with the supply-demand balance for the southern states less certain than that for Queensland. While the ACCC’s projections for the southern states indicate sufficient supply to meet demand in 2020, this is contingent on further decline in demand for gas power generation, which is difficult to forecast accurately. The ACCC notes a number of risk factors, such as lower than expected wind and solar generation, delays in the completion of renewable energy projects and disruptions to the availability of coal-fired generation, that could result in increased demand for gas power generation in 2020.³

In determining the sufficiency of gas supply in 2020, we recommend the Minister take into consideration this uneven distribution of gas and the contingent risks.

The introduction of the ADGSM has done little to ease east coast gas prices, which remain at or near historically high levels. Chart 2 tracks the growth in wholesale gas prices in Victoria and major supply hubs in Sydney, Brisbane and Adelaide.

³ ACCC Gas Inquiry Report 2017-2020 Interim Report July 2019. p.35

Chart 2: Average Daily Gas Prices in Victoria and major supply hubs in Sydney, Brisbane and Adelaide

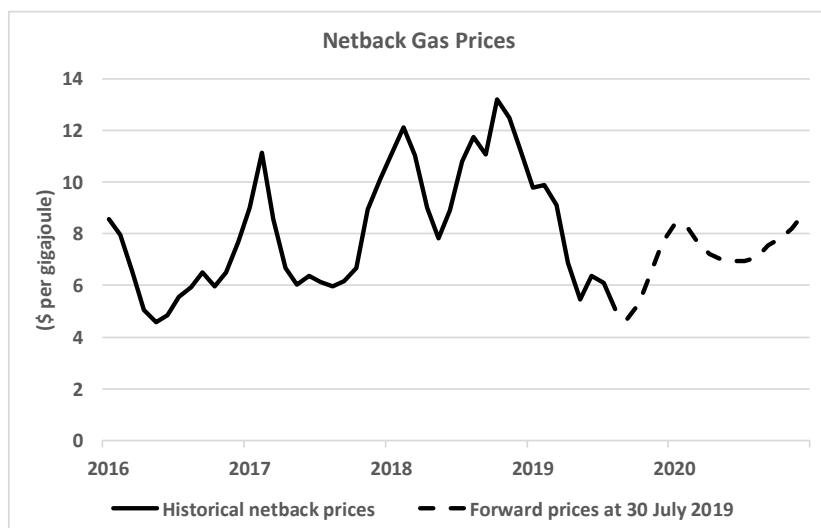


Source: Australian Energy Regulator, Wholesale Gas Statistics https://www.aer.gov.au/wholesale-markets/wholesale-statistics?%5B0%5D=field_accc_aer_stats_category%3A904

Prior to the introduction of the ADGSM in July 2017 gas prices dipped, but have since returned to their previous high. From a low of around \$6.20/GJ in Victoria and \$7.00/GJ in Sydney, Brisbane and Adelaide in July 2017, prices increased to a peak of \$9.80/GJ in Victoria, \$10.00/GJ in Brisbane and around 10.20/GJ in Sydney and Adelaide in early 2018. Prices have since plateaued, but remain at these record high levels. These prices are well in excess of the historic averages of between \$3.00/GJ and \$4.00/GJ that sustained gas-reliant industries prior to 2015.

Since the opening of the LNG export terminals in 2016, the domestic price has typically reflected the volatility in international prices, which can be seen in the LNG netback gas price series tracked by the ACCC (Chart 3).

Chart 3: LNG netback price



Source: Australian Competition and Consumer Commission, LNG netback price series, <https://www.accc.gov.au/regulated-infrastructure/energy/gas-inquiry-2017-2020/lng-netback-price-series>

The LNG netback price is a measure of an export parity price that a gas supplier can expect to receive i.e. the gas price equivalent if it were sold in the domestic market. The ACCC calculate the LNG netback price as the price of LNG in the Asian market, less the cost of compression (liquefaction) in Australia, shipping and regasification in the destination market.

Over the past year, domestic gas prices have diverged from the netback price. While the netback price of gas has fallen sharply from its peak of \$13.20/GJ in October 2018 to \$5.10/GJ in August 2019, this has not been reflected in domestic wholesale gas prices, which have remained high over this period. In the first quarter of 2019, the ACCC Gas Inquiry report found prices offered by retailers to C&I gas users in the east coast gas market have remained in the \$10-\$12/GJ range.⁴ The ACCC report also finds that offers made by producers in Queensland for supply in 2020 have generally eased to slightly to below \$10/GJ. However, prices offered to commercial and industrial users in the NSW and Victoria have mostly remained in the \$10-12/GJ range.

The ADGSM does not seem to have had much effect on the behaviour of gas producers and retailers, in the face of the current supply constraints, weak competition and the linkage to the LNG export market. The ACCC Gas Inquiry report identified that the delivered prices paid by C&I gas users in the east coast market are higher than the prices paid by their competitors in other gas exporting countries (i.e. the US and Canada). It also showed that since the ADGSM was introduced, the average margins of the three largest retailers from sales to C&I customers had grown from 17% in 2016 to 28% in 2018.⁵

The high prices and limited supply have led to a number of closures in gas-reliant industries, including Dow Chemicals in Melbourne, RemaPak in Sydney and Claypave in Queensland. Analysis by the ACCC indicate that many C&I gas users operations are unsustainable over the long-term at the current gas prices.⁶ While they are continuing to operate at marginal costs, they will soon need to make critical decisions on whether to continue to operate in Australia. Some users have already made the decision to expand operations overseas where gas prices are cheaper (i.e. United States, Canada), instead of major capital re-investment in maintenance, replacement or upgrades at their existing Australian facilities.

The impact of the ADGSM on the competitiveness of Australia's liquefied natural gas export industry, Australia's investment reputation and Australia's international reputation for quality and reliability

There is no indication that the ADGSM is impacting on Australia's international competitiveness, investment reputation or international reputation for quality and reliability.

The introduction of the ADGSM in July 2017 has had no observable impact on the reliability of supply into the international market. There have been no disruptions to LNG exports over the past two years.

Australia's LNG exports remain highly competitive in the international market, as reflected in the increase in Australia's market share. Australia's LNG export sector has grown rapidly from the 10th biggest gas exporter in 2015, to become the world's largest LNG exporter by the end of 2018. LNG exports from the east coast have continued to grow, with volume of

⁴ ACCC Gas Inquiry Report 2017-2020 Interim Report July 2019. p.20

⁵ ACCC Gas Inquiry Report 2017-2020 Interim Report July 2019. p.22 - 24

⁶ ACCC Gas Inquiry Report 2017-2020 Interim Report July 2019. p.26

east coast LNG exports up 3% from 1,290 PJ in 2017 to an expectation of 1,328 in 2019.⁷ Australia's total LNG exports (including LNG exports from WA and NT) have also grown strongly over the past two years, with the export volume increasing by 22% in 2018, and the value of these exports increasing by almost 60%.⁸

The threat the ADGSM poses, in terms of the power it gives the Minister to limit LNG exports, seems to have done little to change the behaviour of gas producers and LNG exporters. Producers are still prioritising LNG exports, despite domestic prices appearing to be considerably higher than the netback price of gas supplied into the Asian market. LNG exporters have locked in long-term high volume contracts with their buyers in Asian markets and are continuing to meet their supply commitments, despite the sharp fall in gas prices in Asian markets.

The impact of the ADGSM on the Australian domestic gas market, including the development of new and additional gas resources and market functions

The ADGSM has had no discernible impact on the domestic gas market from the perspective of C&I users.

In the 2 years since its introduction, despite a slight increase in supply (mainly through minor increases from existing production facilities), the ability of C&I users to negotiate short- and long-term contracts for the supply of gas, and/or to access gas from the spot market at reasonable prices, has not improved.

The ACCC Gas Inquiry surveyed a range of C&I gas users to gain insight on their experiences in the east coast gas market over the previous year.⁹ In the survey for the ACCC's July 2019 interim report, gas users reported reduced ability to obtain gas supply, changes in how gas is procured, an increase in prices offered, shorter supply terms offered, increasingly restrictive terms and conditions, and some offers being made on a 'take it or leave it' basis.¹⁰ The combined effect of these factors was a contributing factor to the closure of RemaPak, Claypave and Dow Chemical manufacturing plants.

Investment in the gas industry is large-scale, long-term and there are several phases to this investment in the planning and approvals stages, exploration and development. It is too early to say whether the ADGSM has impacted on investment in exploration and the development of new and additional gas resources. However, there are many other regulatory barriers representing a far greater risk and/or barrier to investment in gas exploration and new gas field developments than the ADGSM.

State regulation — such as the Victorian Government's moratorium on all forms of on-shore gas exploration and off-shore unconventional (coal seam gas) exploration, and the NSW Government's 'go-slow' on environmental assessment for unconventional gas field

⁷ AEMO Gas Statement of Opportunities

⁸ Department of Industry, Innovation and Science, Resources and Energy Quarterly
<https://www.industry.gov.au/data-and-publications/resources-and-energy-quarterly-all>

⁹ ACCC Gas Inquiry Report 2017-2020 Interim Report July 2019. p.74

¹⁰ ACCC Gas Inquiry Report 2017-2020 Interim Report July 2019. p.75.

development — is having a much greater impact on gas exploration and investment decisions than the ADGSM.

In Victoria, the moratorium on on-shore conventional gas exploration is set to expire on 1 July 2020. It is uncertain at this stage whether the Victorian Government will extend the moratorium beyond July 2020. However, even if it were to expire and conventional on-shore gas exploration is allowed, it would be several years before it would be ready to supply new gas to the network, as new projects would need to go through exploration, environmental approvals, and gas field development. Similarly, in NSW which relies on the importation of 98 per cent of its gas requirements from other states, the government recently announced it would commence the environmental approval process for the Narrabri gas field development, which was first proposed in 2016.

Federal and State Governments must focus their attention on lifting these restrictions on gas exploration and extraction now to increase the volume of gas available in the network. If Governments were to explore the option of a national gas reservation scheme in the future, it should be limited to new projects only.

In terms of the development of new LNG compression and export facilities, other market factors are having a greater impact on investment decisions than the ADGSM. Following, substantial investment in the LNG export sector on the east coast over the past five years, there is now a large amount of excess capacity. The three new LNG export facilities in Queensland are operating well below their name-plate capacity. As a result, there is unlikely to be any new investment in LNG compression and export facilities until the excess capacity is absorbed by the market. It is this excess capacity, not the ADGSM, which will have the greatest influence on investment decisions over the next five to 10 years.

There is unlikely to be any significant investment in LNG export on the east coast in the near term. There is interest in expanding LNG exports from the Northern Territory and Western Australia, suggesting the ADGSM is having little impact on investment decisions in other jurisdictions.

Whether improvements can be made to the operation of the ADGSM and whether there are appropriate alternative mechanisms to achieve the objectives of the ADGSM

The ADGSM could be better targeted to improve the outcomes for domestic gas consumers. As noted above, there are a wide range of problems in the domestic gas market related to the availability of supply contracts and gas prices. In its current form, the ADGSM is not addressing these issues, particularly from the perspective of C&I gas users.

To be effective, the scope of the ADGSM could be broadened to focus not just on the sufficiency of supply at an aggregate level across the east coast market, but to consider the sufficiency of supply at the state and regional level. It could also ensure domestic customers, particularly C&I users, have access to short- and long-term supply contracts, on reasonable terms and at affordable prices (i.e. at similar prices to that paid by their competitors in other countries).

We recommend the ADGSM take these factors into consideration when a determination is made on whether to limit LNG exports to ensure the needs of the domestic gas customers are met.

In addition, to support the functioning of the ADGSM, there is a case for greater transparency in the domestic gas market. New measures to require gas producers and LNG exporters to publish real time information on the volume of available gas supply, and detail on the costs of production and delivery of gas to customers, would improve transparency and help the market operate more effectively. This could adopt a similar approach to the information disclosure measures introduced for non-scheme (unregulated) gas transmission pipelines through Part 23 of the National Gas Regulations. NGR Part 23 requires gas transmission pipelines to provide information on pipeline service information including available capacity, financial information including revenue and expenses, and weighted average prices of existing gas supply contracts. A similar detail on producer's available gas volume, financial information and pricing of existing gas supply contracts would better facilitate negotiation of contracts for gas supply for C&I gas users.

ADGSM is a significant regulatory intervention that should only be viewed as a temporary, stop-gap measure that allows the market to adjust to be a more competitive, efficient and effective market. Effort should be directed at freeing-up the market to competition, rather than the addition of further regulation on what is an already heavily regulated and highly distorted market.

Accordingly, we recommend that Australia develops a long-term national gas strategy. A key component of this must be increasing supply, through increased exploration and the development of gas resources on the east coast.

To be consistent with the National Gas Objective, the strategy would be consumer focused, catering for the needs of C&I gas users and residential customers. At the same time, it needs to support the LNG export sector, which is a major contributor to Australia's trade balance and GDP.

In a very short time, LNG exports have grown to become Queensland's second largest merchandise export, after coal, valued at around \$15 billion in the year to May 2019. In addition to meeting the needs of domestic gas users, the strategy also needs to factor in the importance of these exports and limit any disruption to this trade.

The national gas strategy should aim to ensure domestic gas consumers have access to a functioning gas market. Short-term policy priorities should aim to increase competition, create a more interconnected network and improve the efficiency and effectiveness of the gas market. Long-term policy priorities should aim to remove constraints on exploration and gas-field development to increase domestic supply and drive down prices.

In developing the national gas strategy, we recommend the Government work with its State and Territory counterparts through COAG to ensure consistency of policy and regulation in the highly integrated east coast gas market.

Whether the ADGSM should be amended or repealed before 1 January 2023 and the timing of any such amendment or repeal

The ADGSM, as it currently stands, does not seem to serve its intended purpose of ensuring sufficient supply and keeping gas prices affordable for domestic C&I gas users and residential customers.

This review offers the opportunity to consider changes to the ADGSM to ensure it better serves the needs of domestic C&I gas users and residential customers. Consideration could be given to changes that broaden the scope of the factors the Minister takes into account in making a determination on the sufficiency of supply under the ADGSM. The supply demand balance should be assessed not just for the east coast market as a whole, but at the state and regional level. The Minister's decision should also factor in whether domestic customers, particularly C&I users, have access to short- and long-term supply contract, on reasonable terms and at affordable prices.

Following these changes, and prior to the expiry of the ADGSM in 2023, a detailed review should be undertaken to determine its effectiveness in improving supply to domestic customers, as well as progress in developing and implementing the national gas strategy.

The ADGSM should only be viewed as a temporary measure to provide immediate relief to domestic gas customers, while a more comprehensive national gas strategy is developed and implemented. This strategy should aim to achieve a functioning competitive gas market, with a focus on improving the efficiency and effectiveness of the gas market, increasing competition and removing supply constraints.

Australian Chamber of Commerce and Industry

4 September 2019



**Working for business.
Working for Australia**

About the Australian Chamber

The Australian Chamber of Commerce and Industry speaks on behalf of Australian Businesses at home and abroad.

We represent more than 300,000 businesses of all sizes, across all